

equivalent to a dividend" (that is, having the same effect as a distribution without any redemption of stock) shall be made without regard to the earnings and profits of the corporation at the time of the distribution. For example, if A owns all the stock of a corporation and the corporation redeems part of his stock at a time when it has no earnings and profits, the distribution shall be treated as a distribution under section 301 pursuant to section 302(d).

(b) The question whether a distribution in redemption of stock of a shareholder is not essentially equivalent to a dividend under section 302(b)(1) depends upon the facts and circumstances of each case. One of the facts to be considered in making this determination is the constructive stock ownership of such shareholder under section 318(a). All distributions in pro rata redemptions of a part of the stock of a corporation generally will be treated as distributions under section 301 if the corporation has only one class of stock outstanding. However, for distributions in partial liquidation, see section 346. The redemption of all of one class of stock (except section 306 stock) either at one time or in a series of redemptions generally will be considered as a distribution under section 301 if all classes of stock outstanding at the time of the redemption are held in the same proportion. Distribution in redemption of stock may be treated as distributions under section 301 regardless of the provisions of the stock certificate and regardless of whether all stock being redeemed was acquired by the stockholders from whom the stock was redeemed by purchase or otherwise. In every case in which a shareholder transfers stock to the corporation which issued such stock in exchange for property, the facts and circumstances shall be reported on his return except as provided in paragraph (d) of §1.331-1. See sections 346(a) and 6043 for requirements relating to returns by corporations.

(c) In any case in which an amount received in redemption of stock is treated as a distribution of a dividend, proper adjustment of the basis of the remaining stock will be made with respect to the stock redeemed. (For adjustments to basis required for certain

redemptions of corporate shareholders that are treated as extraordinary dividends, see section 1059 and the regulations thereunder.) The following examples illustrate the application of this rule:

Example (1). A, an individual, purchased all of the stock of Corporation X for \$100,000. In 1955 the corporation redeems half of the stock for \$150,000, and it is determined that this amount constitutes a dividend. The remaining stock of Corporation X held by A has a basis of \$100,000.

Example (2). H and W, husband and wife, each own half of the stock of Corporation X. All of the stock was purchased by H for \$100,000 cash. In 1950 H gave one-half of the stock to W, the stock transferred having a value in excess of \$50,000. In 1955 all of the stock of H is redeemed for \$150,000, and it is determined that the distribution to H in redemption of his shares constitutes the distribution of a dividend. Immediately after the transaction, W holds the remaining stock of Corporation X with a basis of \$100,000.

Example (3). The facts are the same as in *Example (2)* with the additional facts that the outstanding stock of Corporation X consists of 1,000 shares and all but 10 shares of the stock of H is redeemed. Immediately after the transaction, H holds 10 shares of the stock of Corporation X with a basis of \$50,000, and W holds 500 shares with a basis of \$50,000.

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§ 1.302-3 Substantially disproportionate redemption.

(a) Section 302(b)(2) provides for the treatment of an amount received in redemption of stock as an amount received in exchange for such stock if—

(1) Immediately after the redemption the shareholder owns less than 50 percent of the total combined voting power of all classes of stock as provided in section 302(b)(2)(B),

(2) The redemption is a substantially disproportionate redemption within the meaning of section 302(b)(2)(C), and

(3) The redemption is not pursuant to a plan described in section 302(b)(2)(D). Section 318(a) (relating to constructive ownership of stock) shall apply both in making the disproportionate redemption test and in determining the percentage of stock ownership after the redemption. The requirements under section 302(b)(2) shall be applied to

each shareholder separately and shall be applied only with respect to stock which is issued and outstanding in the hands of the shareholders. Section 302(b)(2) only applies to a redemption of voting stock or to a redemption of both voting stock and other stock. Section 302(b)(2) does not apply to the redemption solely of nonvoting stock (common or preferred). However, if a redemption is treated as an exchange to a particular shareholder under the terms of section 302(b)(2), such section will apply to the simultaneous redemption of nonvoting preferred stock (which is not section 306 stock) owned by such shareholder and such redemption will also be treated as an exchange. Generally, for purposes of this section, stock which does not have voting rights until the happening of an event, such as a default in the payment of dividends on preferred stock, is not voting stock until the happening of the specified event. Subsection 302(b)(2)(D) provides that a redemption will not be treated as substantially disproportionate if made pursuant to a plan the purpose or effect of which is a series of redemptions which result in the aggregate in a distribution which is not substantially disproportionate. Whether or not such a plan exists will be determined from all the facts and circumstances.

(b) The application of paragraph (a) of this section is illustrated by the following example:

Example. Corporation M has outstanding 400 shares of common stock of which A, B, C and D each own 100 shares or 25 percent. No stock is considered constructively owned by A, B, C or D under section 318. Corporation M redeems 55 shares from A, 25 shares from B, and 20 shares from C. For the redemption to be disproportionate as to any shareholder, such shareholder must own after the redemptions less than 20 percent (80 percent of 25 percent) of the 300 shares of stock then outstanding. After the redemptions, A owns 45 shares (15 percent), B owns 75 shares (25 percent), and C owns 80 shares (26 2/3 percent). The distribution is disproportionate only with respect to A.

§ 1.302-4 Termination of shareholder's interest.

Section 302(b)(3) provides that a distribution in redemption of all of the stock of the corporation owned by a

shareholder shall be treated as a distribution in part or full payment in exchange for the stock of such shareholder. In determining whether all of the stock of the shareholder has been redeemed, the general rule of section 302(c)(1) requires that the rules of constructive ownership provided in section 318(a) shall apply. Section 302(c)(2), however, provides that section 318(a)(1) (relating to constructive ownership of stock owned by members of a family) shall not apply where the specific requirements of section 302(c)(2) are met. The following rules shall be applicable in determining whether the specific requirements of section 302(c)(2) are met:

(a)(1) The agreement specified in section 302(c)(2)(A)(iii) shall be in the form of a separate statement in duplicate signed by the distributee and attached to the first return filed by the distributee for the taxable year in which the distribution described in section 302(b)(3) occurs. The agreement shall recite that the distributee has not acquired, other than by bequest or inheritance, any interest in the corporation (as described in section 302(c)(2)(A)(i)) since the distribution and that the distributee agrees to notify the district director for the internal revenue district in which the distributee resides of any acquisition, other than by bequest or inheritance, of such an interest in the corporation within 30 days after the acquisition, if the acquisition occurs within 10 years from the date of the distribution.

(2) If the distributee fails to file the agreement specified in section 302(c)(2)(A)(iii) at the time provided in paragraph (a)(1) of this section, then the district director for the internal revenue district in which the distributee resided at the time of filing the first return for the taxable year in which the distribution occurred shall grant a reasonable extension of time for filing such agreement, provided (i) it is established to the satisfaction of the district director that there was reasonable cause for failure to file the agreement within the prescribed time and (ii) a request for such extension is filed within such time as the district director considers reasonable under the circumstances.